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SUBJECT: ROMANIA'S DRAFT ENERGY STRATEGY - A MIXED BAG

REF: A. 06 BUCHAREST 411

[1](#)B. 06 BUCHAREST 1653

Classified By: Deputy Chief of Mission Mark Taplin for reasons 1.5 (b) and (d).

SUMMARY

[1](#)1. (C) The Ministry of Economy and Finance released a draft of the national energy strategy for public comment on May 18.

The draft strategy outlines the GOR's priorities in developing its energy profile (e.g. nuclear, thermal, hydro, renewable), privatizing remaining state-owned energy assets, and participating in international energy projects. While the strategy lays out a reasoned approach to increased energy independence and proscribes certain positive policy changes, particularly in the field of natural gas market regulation, the bulk of the strategy leaves much to be desired, and in some instances increases opportunities for corruption. Other aspects represent short-sighted political overtures to labor and other interest groups, such as calls to grant further debt relief to wasteful state-owned power generators and bundle inefficient thermal producers with low-cost hydro plants. Such items may face scrutiny from European Commission entities, including the Directorate General for Competition. Government insiders indicate that there was little inter-agency coordination of the document. Early public reaction has been largely negative. Minister of Economy and Finance Varujan Vosganian has pledged to meet with stakeholders to "improve" the document. END SUMMARY.

[1](#)2. (U) Like much of Europe, Romania faces continued depletion of its domestic oil and gas reserves. In addition, a large percentage of Romania's current power infrastructure requires capital investment for upgrades or replacement, particularly in the coal-based production sector. Current estimates are that gas reserves face depletion by 2040 and oil reserves by 2070. Romania's draft energy strategy calls for increased emphasis on nuclear and hydro power, increased investment in renewable energy, and improved energy efficiency. The draft envisions an increase in the national share of nuclear to 15% and hydro to 30% in 2010. Romania relies on Russia for all gas imports, which currently approximate 40% of demand. Estimating that reliance on imported gas will increase to 53% in 2010, the draft strategy recognizes the need to diversify supply options, specifically mentioning the Nabucco pipeline project.

INTERNATIONAL PRIORITIES

[1](#)3. (U) Romania's draft national energy strategy identifies several prominent international projects as national priorities. Included among these are the Nabucco natural gas pipeline and the Pan-European Oil Pipeline (PEOP). The Nabucco pipeline would deliver Caspian Sea gas reserves to

Central Europe via Turkey, Bulgaria, Romania, Hungary and Austria. PEOB would serve as a Bosphorus bypass for Caspian and Central Asian oil, running from the port of Constanta in Romania to Trieste in Italy via Bulgaria, Hungary, Croatia and Slovenia.

¶4. (C) The draft strategy also calls for completion of a feasibility study for an LNG terminal on the Black Sea coast. This project appears to be an extension of GOR discussions with Qatar to provide Qatari gas to the regional market. However, the project hinges on the ability of LNG tankers to traverse the Bosphorus, a scenario complicated by required Turkish permission. Other projects include increased use of LPG to level consumption spikes and completing a high capacity electrical cable connection under the Black Sea to Turkey.

APPROACH TO OIL AND GAS

¶5. (U) The draft national energy strategy calls for application of more transparent market rules in the natural gas sector. This process was begun in April 2007 with the merger of the Natural Gas and the National Energy Regulatory Authorities. In theory, the gas sector will be subject to supervision and monitoring methods applied in the energy market.

¶6. (U) However, the plan makes no mention of a price approach to domestically produced natural gas, currently maintained at well below import prices. The GOR has made prior commitments to both the European Commission and the International Monetary Fund to move to market-based pricing for domestic gas. The lack of a specific timeframe is at odds with this commitment.

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¶7. (U) In a positive move, the strategy calls for transferring ownership of local oil and gas pipeline networks to the operators, reversing a decision taken in 2001 that has resulted in discontent among operators and their investors.

STRATEGIC ENERGY ASSETS TO REMAIN STATE-OWNED

¶8. (U) The draft strategy identifies certain state-owned energy assets as strategic, and not subject to privatization. These include Cernavoda nuclear power plant reactors one and two (future reactors may be developed as part of a public-private partnership) and hydro power plants on the Danube (i.e. the Iron Gates complex) and two other major rivers (the Olt and Lotru).

¶9. (C) The strategy also identifies state-owned natural gas producer Romgaz as strategic. While similar companies in the oil and gas sector such as Petrom/OMV have already been privatized, the GOR is hesitant to fully relinquish control over gas resources. Minister Vosgianian envisions transforming the company into a state-owned regional player in the same mode as the Czech Republic's CEZ or a Gaz de France. However, as a GOR-controlled company, Romgaz is subject to political patronage positions, often resulting in poor management decisions. Certain GOR officials have expressed concerns over increased Russian presence on the domestic energy market and Gazprom has already raised its interest in acquiring the company.

PRIVATIZATION PROGRESSING AT A SNAIL'S PACE

¶10. (C) While certain assets will remain state-owned, the draft energy strategy calls for privatizing major energy assets, including the Turceni, Rovinari and Craiova coal-fired thermal energy complexes, by the end of 2008. These three complexes and others have been subject to privatization discussions for several years now. European Commission pre-accession reports repeatedly called for the Romanian state to conclude the privatization process to allow

for much needed capital investments. The state has remained hesitant to do so, in part due to the loss of cozy electrical energy contracts at low rates for politically-connected companies and for fear that private owners would drastically reduce employment.

¶11. (C) Due to the heavy investments needed to bring the plants up to European environmental standards, legitimate international companies would be unlikely to pay more than a symbolic price for the state-owned assets on offer. However, in a touchy political environment, GOR officials worry that they will expose themselves to accusations of giving away the patrimony should the sales price be too low. This concern has been at the heart of delays, and may result in either a failed privatization process or privatizing to unhealthy entities. However, in the absence of significant private investment, the facilities could face closure for non-compliance with European environmental standards. Romania negotiated an extension on environmental standards to ¶2013.

DEBT FORGIVENESS OR INSOLVENCY?

¶12. (C) Another concern outlined in the draft strategy is settlement of historic debts for the three energy complexes and for the heavily indebted coal and gas-based power plant operator Termoelectrica. In its plea to the EC, which must approve such state aid, the GOR claims that the alternatives for Termoelectrica are debt forgiveness or insolvency. While debt forgiveness may be a necessary condition for privatization, the GOR has yet to convincingly commit to this approach. Debt forgiveness without privatization would merely enable the cycle of continued inefficiencies and re-accumulation of debt.

MINING-RELATED SOCIAL CONCERNS

¶13. (U) The Jiu Valley in southwestern Romania is the source of coal for much of Romania's thermal production and a politically sensitive region. The draft strategy specifically addresses concerns that private investors would import cheaper coal to the disadvantage of the inefficient mining companies in the Jiu Valley, and suggests imposing a requirement to source coal domestically. Past mine closures have resulted in disruptive strikes, and even a miner's march on Bucharest in 1999 that resulted in street violence. The release of the draft energy strategy has already resulted in strikes in all three facilities involving over 15,000 employees.

THE DEVIL IN THE DETAILS

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¶14. (C) Such political concerns have resulted in some problematic suggestions. The draft strategy suggests unnaturally bundling mining, thermal and hydro power plants into the state-owned hydropower producer Hidroelectrica. Such a move would result in hydropower subsidizing inefficient mining and thermal power generation most of the year. Mixing low-cost hydro and higher-cost thermal production would also further decrease market transparency by masking the actual cost of production in energy contracts and obscuring inefficiencies in the thermal sector. The World Bank and EC recommend relying on "natural consolidation" by bringing facilities to market individually. Market operators could purchase those facilities that fit most naturally into their production basket based on regional and cost criteria.

¶15. (C) The draft strategy also identifies a need to secure power supply to energy intensive industrial consumers. Many such consumers already benefit from sweetheart arrangements. The largest energy consumer in Romania, Russian-owned Alro Aluminum, secretly concluded a market-distorting, exclusive arrangement for low-cost hydropower until 2013. Western investors in regional power companies have called for an end

to bilateral contracts concluded outside Romania's energy exchange. The strategy's language on guaranteeing large consumer's power supply appears to be a defense of the status quo.

FUTURE INVESTMENTS IN NUCLEAR AND CLEAN COAL

¶16. (C) The draft strategy calls for increased underground gas storage capacity through new sites in Northeast Romania (Margineni) and in areas adjacent to the Nabucco project. (Note: Gazprom expressed interest in the Margineni project, but has balked at financing start up costs.) The state also plans to construct two additional nuclear reactors at Cernavoda, and has already sought letters of interest. Such a move could potentially bring the share of nuclear-generated power to 30%, further increasing Romania's energy independence. Increased use of nuclear power would alleviate pressure on Romania's dated coal-based power generation and facilitate greater exports. However, the GOR has yet to determine the method by which it would provide co-financing and the terms of the public-private partnership. Several domestic firms, including Russian-owned Alro Aluminum, have expressed interest and are salivating at the idea of dedicated cheap energy. The GOR also plans public-private partnerships in a new clean coal-based power plant in Braila and in the five power plants that supply power and heat to Bucharest and its outskirts. Other areas generally identified for investment include biofuel, wind power, and small hydro facilities.

GARBAGE IN, GARBAGE OUT

¶17. (SBU) Initial response to the strategy has been critical, and reflects the sequestered nature in which it was developed. GOR contacts who should naturally have been involved in the process were not. There has been little consultation within the Ministry of Economy and Finance and among other relevant Ministries, let alone with political parties outside the governing coalition. A consultative commission established by the Prime Minister met only once, and was not involved at all in directing the project. Both labor and business groups have voiced serious complaints and the main opposition Social Democrat Party (PSD) has rejected much of the plan. However, the Ministry has announced only a brief comment period until May 25, well short of the 30-60 day requirement under Romanian law. Minister of Economy and Finance Varujan Vosganian has pledged to meet with stakeholders to discuss concerns.

COMMENT

¶18. (SBU) While containing many sound policy prescriptions, Romania's draft national energy strategy remains a flawed document, with political considerations playing a too central role in its final formulation. Elements of the strategy ignore market realities and pander to labor concerns in the dying coal-mining districts. Other elements, such as recommendations to bundle high- and low-cost energy production and dedicate secure power to large consumers, are non-transparent and open the door to corruption opportunities. Such policies amount to continued subsidies to Romania's energy-intensive dinosaur industries, the vast majority of which are owned by local oligarchic interests. Public reaction has been largely negative, necessitating likely further revisions. The document is largely a product of the governing National Liberal Party (PNL), raising serious questions about its staying power should there be a

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change in government. If Romania wishes to play a role in Europe's energy strategy formulation, as it attests, the current draft strategy is not the best basis from which to work.

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